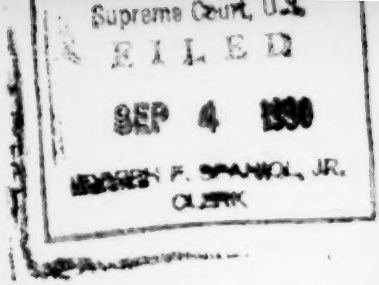

90-428

No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1989

RICHARD E. CHITWOOD and
EMMA A. CHITWOOD, Petitioners,

v.

JOHN C. McLEMORE, TRUSTEE IN BANKRUPTCY
FOR CIRCLE W. DAIRY FARMS, et al.,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. DOES A 'COMMON-LAW COMPULSORY COUNTERCLAIMS RULE' BAR LITIGATION OF CLAIMS AS A MATTER OF RES JUDICATA WHEN SUCH LITIGATION WOULD NOT BE BARRED BY RULE 13(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE?

2. DID THE RESPONDENT'S EQUITABLE SUBORDINATION PROCEEDING AGAINST THE PETITIONERS IN BANKRUPTCY COURT ARISE FROM THE SAME TRANSACTION AS THE PETITIONERS' DISTRICT COURT SUIT AGAINST THE RESPONDENT?

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IN THE SUPREME COURT OF THE UNITED STATES

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RICHARD E. CHITWOOD and
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v.

JOHN C. McLEMORE, TRUSTEE IN BANKRUPTCY
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Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The petitoners, Richard E. Chitwood and Emma A. Chitwood, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit, entered in this proceeding on June 6, 1990.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit is not reported and was not recommended for full-text publication pursuant to Sixth Circuit Rule 24. It is reprinted in the appendix hereto, p. 1a, infra.

The memorandum opinion and order of the Untied States District Court for the Middle District of Tennessee (Nixon, J.) is not reported. It is reprinted in the appendix hereto, p. 13a, infra.

The order of the United States Bankruptcy Court for the Middle District of Tennessee (Paine, J.) is not reported. It is reprinted in the appendix hereto, p. 33a, infra.

JURISDICTION

The Sixth Circuit on June 6, 1990, entered a judgment and opinion affirming the district court's granting of respondent's motion for summary judgment. No petition for rehearing was filed.

The jurisdiction of this Court to review the judgment of the Sixth Circuit is invoked under 28 U.S.C. 1254(1).

RULES INVOLVED

Rule 13(a), Federal Rules of Civil Procedure

Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleaser has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's

claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. But the pleader need not state the claim if (1) at the time the action was commenced the claim was the subject of another pending action, or (2) the opposing party brought suit upon the claim by attachment or other process by which the court did not acquire jurisdiction to render a personal judgment on that claim, and the pleader is not stating any counterclaim under this Rule 13.

Rule 7013, Bankruptcy Rules

Counterclaim and Cross-Claim Rule 13 F.R.Civ.P. applies in adversary proceedings, except that a party sued by a trustee or debtor in possession need not state as a counterclaim any claim that the party has against the debtor,

the debtor's property, or the estate, unless the claim arose after the entry of an order for relief. . . .

STATEMENT OF THE CASE

In 1981 and 1982, petitioners purchased 150 head of dairy cattle and leased them to Circle W. Dairy Farms and Willard Weaver. By early September, 1982, it was obvious to the petitioners that the dairy operation was failing and that the lessees were in breach of the lease. On September 6, 1982, the petitioners terminated the leases and arranged for the dairy cattle that they identified as theirs to be transported to another dairy operation. The cattle with Petitioners' brand, together with the cattle of other lessors, were moved from the Circle W. Dairy Farms on September 15, 1982. On September 26, 1982, Willard

Weaver and his Circle W. Dairy Farms filed bankruptcy.

On October 22, 1982, the respondent, the newly appointed bankruptcy trustee, arrived at the dairy farm, determined that cattle had been removed, and recovered them, including the cattle with petitioners' brand. Invoking federal jurisdiction under 28 U.S.C. 1332, the petitioners brought this lawsuit against respondent in the Middle District of Tennessee on August 21, 1984. As amended, the complaint stated five grounds for relief arising from respondent's taking of petitioners' cattle which was wrongful because the leases with the debtor were terminated before the bankruptcy filing.

Trial of this case began before the Honorable Thomas A. Wiseman, Jr., of the Middle District of Tennessee on August 3, 1987. However, Judge Wiseman declared a

mistrial and recused himself when he learned during the third day of trial that he had signed an order in the related bankruptcy case. The lawsuit was then assigned to the Honorable John T. Nixon of the Middle District for re-trial.

Before the re-trial, petitioners filed an objection in the bankruptcy court to the payment of certain claims in the related bankruptcy case. The respondent answered the objection and also filed an equitable subordination action in the bankruptcy court alleging that Richard Chitwood had engaged in misconduct by misbranding the cattle that were removed from the debtor dairy farm. The bankruptcy judge, the Honorable George C. Paine, II, found in the respondent's favor and ordered that Richard Chitwood's claims and interest be

subordinated to the claims and interests of other persons. The bankruptcy judge did not rule on the question of whether the leases were in force at the time of the bankruptcy filing and did not find that the petitioners owned no cattle located on the bankrupt's dairy farm at the time of the bankruptcy filing.

The respondent then filed a summary judgment motion in district court seeking dismissal of the petitioners' lawsuit against him on the theory that the bankruptcy judge's order barred the petitioners' claims as a matter of res judicata. That motion was granted and reaffirmed on September 19, 1988. See p. 13a, infra. Petitoners filed their notice of appeal on October 14, 1988. The district court's action was affirmed by the Sixth Circuit on June 6, 1990.

REASONS FOR GRANTING THE WRIT

I. The Sixth Circuit's use of the 'common-law compulsory counterclaims rule' to undercut Rule 13(a) of the Federal Rules of Civil Procedure presents an important question of federal law which this Court should resolve.

The decision below holds that a party can be barred by res judicata from proceeding with a claim which is pending in a district court action by failing to raise it in a bankruptcy court action. The Sixth Circuit's holding is based on a "common law compulsory counterclaims rule." That holding conflicts with the explicit language of Rule 13(a) of the Federal Rules of Civil Procedure which is applied in bankruptcy court adversary proceedings under Rule 7013 of the Bankruptcy Rules. The federal rule, as

opposed to the "common law compulsory counterclaims rule," is that a compulsory counterclaim need not be stated if, at the time the later action was commenced, the claim was pending in an earlier action.

There is no doubt that claim preclusion bars a plaintiff from splitting causes of action. A final judgment is final as to every matter raised and as to those matters which could have been raised. Nevada v. United States, 463 U.S. 110, 129 (1983); Cromwell v. City of Sac, 94 U.S. 351, 352 (1877). The policies underlying claim preclusion justify its strict application in most settings where a party has failed to raise an 'admissible' claim. University of Tennessee v. Elliott, 478 U.S. 788 (1986).

However, claim preclusion should not

apply when a party's failure to raise a claim is based on the plain language of Rule 13(a). There was no need to repeat the five causes of action in the district court lawsuit as counterclaims to the adversary proceeding in bankruptcy court.

The Sixth Circuit found the "common law compulsory counterclaim rule" in the Tenth Circuit case, Circle v. Jim Walter Homes, Inc., 654 F.2d 688, 691 (10th Cir. 1981). However, that case delved into the common law of Oklahoma because Oklahoma did not have a compulsory counterclaim statute. That analysis is not necessary under Rule 13(a) of the Federal Rules of Civil Procedure.

Futhermore, if the district court lawsuit were permitted to go forward, even a judgment in favor of the petitioner's would not undermine the bankruptcy court's judgment. Collateral

estoppel prevents the petitioner's from denying that Mr. Chitwood was involved in misbranding cattle. However, it does not prevent the petitioners from proving that the cattle leases were terminated before the bankruptcy filing and, therefore, that the bankrupt estate had no right to the petitioner's cattle at the time of the filing. Even if they did not own the cattle that were misbranded, collateral estoppel would not prevent the petitioners from proving that they owned other cattle in the bankrupt's possession. The bankruptcy judge did not find that the petitioners had no interest or claim, but merely that such interest or claim should be equitably subordinated to the claims of others.

The Federal Rules of Civil Procedure were designed largely to get away from "old procedural booby traps." Surowitz

v. Hilton Hotels Corp., 383 U.S. 363, 373, rehearing denied, 384 U.S. 915 (1966). The Sixth Circuit's decision and reliance on a "common law compulsory counterclaims rule" is contrary to the spirit of the rules because it permits a decison on the merits of the district court claims to be avoided on the basis of a mere technicality. See, Forman v. Davis, 371 U.S. 178, 181-82 (1962), on remand, 316 F.2d 254 (1st Cir. 1963).

II. The decision below defines the term "same transaction" in a way that conflicts with decisions of this Court.

The decision below expands the preclusive effect of res judicata beyond that permitted by prior decisions of this Court. The failure to raise the five causes of action in the district court

lawsuit as counterclaims in the bankruptcy court adversary proceeding has no preclusive effect unless both cases arose from the same cause of action. Montana v. United States, 440 U.S. 147, 153 (1979). Whether they arose from the same cause of action is to be determined on a trasanctional basis: whether the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties expectations or business understanding or usuage. Nevada v. United States, 467 U.S. 110, 130 n. 12 (1983)(citing REST. (SECOND) OF JUDGMENTS, sec. 24 [1982]).

The issue of whether Mr. Chitwood participated in the misbranding of cattle might go the the issue of damages in the district court lawsuit: How many cattle

did the petitioners actually own? However, the equitable subordination proceeding does not arise from the same cause of action or transaction as the district court lawsuit which focused on the trustee's right to take possession of petitioners' cattle wherever they were found and however they were branded.

The district judge's formulation, relied on by the Sixth Circuit, was that the issue of cattle ownership was in dispute at the bankruptcy proceeding because, if the petitioners had proven that they owned the cattle (which were allegedly misbranded), the bankruptcy judge would have denied the request for equitable subordination. (App. 7)

That formulation is not congruent with this Court's definition of "cause of action" for res judicata purposes. Even if Mr. Chitwood misbranded some cattle,

that does not mean that the petitioners did not own other cattle which had been leased to the bankrupt. And it certainly does not address the underlying claim in the district court lawsuit that the cattle leases were terminated before the bankruptcy filing, thereby limiting the trustee's power over any cattle, however branded, which the petitioners did own.

> Because res judicata may govern grounds and defenses not previously litigated, however, it blockades unexplored paths that may lead to truth. For the sake of repose, res judicata shields the fraud and the cheat as well as the honest person. It therefore is to be invoked only after careful inquiry.

Brown v. Felson, 442 U.S. 127, 132 (1979). Petitoners submit that a careful inquiry will reveal that the

Sixth Circuit enforced repose on issues not actually litigated which were not part of the cause of action raised in the equitable subordiation hearing.

CONCLUSION

For these various reasons, the writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

No. 88-6203

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

RICHARD E. CHITWOOD and EMMA A. CHITWOOD,	:	
Platintiffs-Appellants	:	ON APPEAL FROM
v.	:	THE UNITED STATES
JOHN C. McLEMORE, TRUSTEE IN BANKRUPTCY FOR CIRCLE W. DAIRY FARMS, et al.	:	DISTRICT COURT FOR THE MIDDLE DISTRICT OF TENNESSEE
Defendant-Appellee	:	

BEFORE: JONES and KRUPANSKY, Circuit Judges; and PECK, Senior Circuit Judge.

PER CURIAM. Plaintiffs appeal the order denying their motion to set aside the entry of summary judgment for defendant on grounds of collateral estoppel in this diversity action for conversion of property.

I.

On September 26, 1982, the debtors

Willard and Ivanelle Weaver and Circle W. Dairy Farms filed for bankruptcy in United States Bankruptcy Court for the Middle District of Tennessee. John C. McLemore was appointed as bankruptcy Trustee. Prior to the declaration of bankruptcy, the Chitwoods had leased cattle to the Weavers doing business as Circle W. Dairy Farms. They claim that before September 1982, the leases came into default due to non-payment and were thus terminated under the terms of the lease and by agreement between the parties. McLemore contends that the leases were not terminated prior to October 1982. It is undisputed that the Chitwoods directed that certain cattle be removed to a third party's farm and that McLemore retrieved these cattle and returned them to the Weaver farm. After his appointment as bankruptcy trustee for

the Weaver estate, McLemore managed the herd on the Weavr's farm until he sold the cattle in February 1983.

McLemore notified all creditors of the sale and applied to the Honorable George Paine, United States Bankruptcy Judge, for an order authorizing the sale of the cattle free and clear of all rights and claims, by lien, ownership or otherwise. The Chitwoods filed and served written objections to the sale, but the objections were withdrawn. Judge Paine held a hearing on February 15, 1983 and subsequently entered an order authorizing the sale of the cattle. The sale was later confirmed by the Honorable Thomas A. Wiseman in an order dated May 20, 1983.

The Chitwoods then commenced this action in the United States District for the Eastern District of Michigan,

alleging that the Trustee's sale constituted conversion of his cattle. Meanwhile, in November of 1987, McLemore filed a complaint in the United States Bankruptcy Court seeking equitable subordination of the Chitwoods' claims and interests in the Weaver's estate. Judge Paine issued an order to that effect, specifically finding "that the cows on the Weaver farm were there as a result of leases with various persons or were owned by Weaver and subject to duly perfected security interests of creditors. Those cattle were indiscriminatorily branded without any attempt being made to determine the true interest holder." The court found the Chitwoods guilty of misconduct resulting in injury to the creditors of the estate and loss to claimants and interest holders whose cattle could not be

accurately identified. McLemore then filed a motion for summary judgment in the district court. The court, which granted the motion, held that the Chitwoods were precluded from bringing their conversion claims in district court because they had been given the opportunity to litigate those claims before the bankruptcy court. The Chitwoods filed timely notice of appeal on October 14, 1989.

II.

We review de novo the decision of the district court to grant summary judgment. Celotex Corp. v. Catrett, 477 US 317 (1986). Fed. R. Civ. P. Rule 56 provides that a court may enter summary judgment on a claim if "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." "The

moving party is 'entitled to a judgment as a matter of law' [where] the nonmoving party has failed to make a sufficient showing on an esential element of her case. . . ." Celotex, 477 U.S. at 323 (citation omitted). The non-moving party cannot merely rest on the allegations of the pleadings, but must present "significant probative evidence tending to support the complaint." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (quoting First National Bank of Arizona v. Cities Service Co., 391 U.S. 253, 290 (1968).

The Chitwoods contend that there is no identity of issues between the equitable subordination hearing before the bankruptcy court and the instant action. They argue that the issue of cattle ownership was not specifically determined and that the bankruptcy court

was not called upon to determine McLemores's liability for conversion. The district court held that:

> the issue of cattle ownership was in dispute at the bankruptcy proceeding. If the plaintiffs had proved that they owned the cattle at the November bankruptcy hearing, Judge Paine would not have granted the Trustee's request for equitable subordination.
>
> In order to establish that subordination is appropriate, McLemore had to prove that: (1) the claimant engaged in some type of inequitable conduct; (2) the misconduct resulted in injury to the creditors of the bankrupt or conferred an unfair advantage to the claimant; and (3) the equitable subordination of the claimant was

not inconsistent with the provisions of the bankruptcy code. Benjamin v. Diamond (In Re Mobile Steel Co.), 563 F.2d 692, 700 (5th Cir. 1977); see also In re B & L Laboratories, 62 B.R. 494, 510 and n. 36 (M.D. Tenn. 1986). If the plaintiffs had proved that the Trustee was liable for converting cattle owned free and clear by the Chitwoods, equitable subordination of the plaintiffs claim would be inconsistent with the bankruptcy code. Thus, the question of whether the Chitwoods owned the cattle was clearly an issue in the bankruptcy proceeding. Indeed, Judge Paine determined that at the time defendant Trustee found the cattle on the farm, the cattle had been "indiscriminately branded without any attempt being made to

determine the true interest holder." J. App. at 48

The doctrine of res judicata provides that if a demand or claim in controversy has been litigated in a prior suit, "judgment estops not only as to every ground of recovery or defense actually presented in the action, but also as to every ground which might have been presented." James v. Gerber Products Co., 587 F.2d 324, 328 (6th Cir. 1978). Collateral estoppel applies when specific issues have been litigated in a previous action involving a different claim in controversy between the same parties or their privies. Tippler v. E. I. DuPont deNemours and Co., 443 F.2d 125, 128 (6th Cir. 1971).

In Chicot County Drainage District v. Baxter State Bank, 308 U.S. 371 (1940), the Supreme Court held that each

party to a bankruptcy proceeding must raise all relevant issues and claims at that time. The Chitwoods argue that Chicot does not apply to their claims because failure to assert a counterclaim does not bar its subsequent assertion as an independent claim for relief when the counterclaim is not compulsory. However, the legal test for determining claim preclusion is not whether the five counts of the Chitwood's claim are compulsory counterclaims under Fed. R. Civ. P. 13(a). The "common-law compulsory counterclaims rule" also forecloses a subsequent claim when allowance of a subsequent action would so plainly operate to undermine the initial judgment that the prinicple of finality requires preclusion of such an action. Circle v. Jim Walter Homes, Inc., 654 F.2d 688 (10th Cir. 1981). In Circle, home buyers

brought suit for alleged violations of the Uniform Commercial Credit Code. The court held the suit was barred by a prior foreclosure suit: "The same basic set of facts, of course, may constitute both a defense to a claim by an opposing party and the basis of a lawsuit against that party." Id. at 691. The court ruled that the common-law compulsory counterclaim rule precluded the subsequent suit, even though the claims for Uniform Commercial Credit code violations were not compulsory counterclaims in connection with the foreclosure suit.

In the instant case, we find that the district court correctly determined that the Supreme Court's decision in Chicot applies because the Chitwoods' claims are predicated upon the same facts which gave rise to the trustee's

equitable subordination claim. The central issue in both cases was ownership and rights to the particular cattle. That issue was decided by the bankruptcy court adversely to the Chitwoods. Relitigation would only serve to undermine the bankruptcy court judgment and disturb settled rights in contravention of the law of collateral estoppel.

III.

For the foregoing reasons, we AFFIRM the judgment of the district court.

IN THE UNITED STATES DISTRICT COURT FOR
THE MIDDLE DISTRICT OF TENNESSEE,
NASHVILLE DIVISION

RICHARD E. CHITWOOD, ET UX.	)	
VS.	)	DOCKET NO. 1-84-0071
JOHN C. MCLEMORE, TRUSTEE IN BANKRUPTCY FOR CIRCLE W. DAIRY FARMS, ET AL.	)	

MEMORANDUM

Pending before the Court is plaintiffs' motion to set aside the Court's Order, entered July 1, 1988, granting the defendant's motion for summary judgment. Pursuant to Rule 60 of the Federal Rules of Civil Procedure, a Court may relieve a party or a party's legal representative from a final judgment, order or proceeding, upon proper motion, if the moving party can demonstrate excusable neglect. The Court

finds that the plaintiff's failure to file a timely answer to defendant's motion in the instant case was excusable and has considered the merits of defendant's motion for summary judgment. Having reviewed the entire file, the Court hereby DENIES plaintiffs' motion to set aside the order granting summary judgment.

I. FACTS

Plaintiffs' claims arise out of certain agreements involving the lease of plaintiffs' cattle between himself and Willard and Ivanelle Weaver d/b/a Circle W. Dairy Farms. Plaintiffs claim that prior to September 1982, the leases came into default due to non-payment and were thus terminated under the terms of the lease and by agreement between the parties. Defendants contend that such leases were not terminated prior to

October 1982. It is undisputed that the plaintiffs directed that certain cattle be removed to a third party's farm ("Hill Farm"), and that the Trustee retrieved these cattle and returned them to the Weaver farm. After his appointment as bankruptcy trustee for the Weaver estate, defendant Trustee managed the herd on the Weaver's farm until he sold the cattle in February 1983.

Defendant Trustee notified all creditors of the sale and applied to the Honorable George Paine, United Sates Bankruptcy Judge, for an order authorizing the sale of the cattle free and clear of all rights and claims, by lien, ownership or otherwise. The Chitwoods filed and served written objections to the sale, but the objections were withdrawn. Judge Paine held a hearing on February 15, 1983 and

subsequently entered an Order authorizing the sale fo the cattle. The sale was later confirmed by the Honorable Thomas A. Wiseman in an Order dated May 20, 1983.

Plaintiff then commenced this action in the Untied States District Court alleging that the Trustee's sale constituted conversion of the Chitwoods' cattle and seeking relief on other gournds as stated in the complaint. This case was originally assigned to the Honorable Thomas A. Wiseman. In August of 1987, Judge Wiseman recused himself and the case was referred to this Court. Meanwhile, in November of 1987, defendant Trustee filed a complaint in the Untied States Bankruptcy Court seeking equitable subordination of the Chitwood's calims and interests in the debtor's estate, and Judge Paine issued an order to that

effect.

II. CONCLUSIONS OF LAW

A. STANDARDS FOR GRANTING SUMMARY JUDGMENT

In Anderson v. Liberty Lobby, Inc., 106 S.Ct. 2505 (1986), the United States Supreme Court explained the District Coruit's function in ruling upon a motion for summary judgment:

> Rule 56(c) of the Federal Rules of Civil Procedure provides that "summary judgment shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is not genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." By its very terms, this

standard provides that the mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact.

As to materiality, the substantive law will identify which facts are material. Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment. Factual disputes that are irrelevant or unnecessary will not be counted.

* * *

More important for present purposes, summary judgment will not lie if the dispute about a material fact is

"genuine" that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party.

106 S.Ct. at 2510. The Supreme Court then concluded "that the determination of whether a given factual dispute requires submission to a jury must be guided by the substantive evidentiary standards that apply to the case." Id. at 25134. Moreover, the party that opposes the motion has the burden to come forth with requisite proof to support its legal claim, particularly where the opposing party has had an opportunity to conduct discovery. Celotex Corp. v. Catrett, 106 S.Ct. 2584 (1986).

It is likewise true that "[i]n ruling on a motion for summary judgment, the court must construe the evidence in its most favorable light in favor of the

party opposing the motion and against the movant. Further, the papers supporting the movant are closely scrutinized, whereas the opponent's are indulgently treated. [citation omitted]. It has been stated that: 'the purpose of the hearing on the motion for such a judgment is not to resolve factual issues. It is to determine whether there is any genuine issue of material fact in dispute. . .'" Bohn Aluminum & Brass Corp. v. Storm King Corp., 303 F.2d 425, 427 (6th Cir. 1962). As the court of appeals stated recently:

> [s]ummary judgment may only be granted when the pleadings, depositions, answers to interrogatories, admissions and affidavits demonstrate that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as matter of

> law. Rule 56(c), Fed. R. Civ. P. All facts and inferences to be drawn thereform must be read in a light most favorable to the party opposing the motion.

Duchon v. Cajon Company, 791 F.2d 43, 46 (6th Cir. 1986).

In the instant case, though the parties are in dispute as to certain facts concerning the termination of the leases and other aspects of the underlying lawsuit, neither party contests that following the bankruptcy hearing in February, 1983, plaintiffs initiated this action in United States District Court. Further, neither party contests that defendant Trustee sought and was granted equitable subordination of the plaintiffs' claims to the Weaver estate in the November, 1987 bankruptcy hearing. The facts material to the res

judicata issue are not in dispute. Therefore, the Court must decide whether the previous bankruptcy adjudication is entitled to have preclusive effect as a matter of law.

B. Res Judicata

The defendants seek summary judgment based on the doctrine of res judicata. The doctrine of res judicata provides that if a demand or claim in controversy has been litigated in a prior suit, the prior "judgment estops not only as to every ground of recovery or defense actually presented in the action, but also as to every ground which might have been presented." James v. Gerber Products Co., 587 F.2d 2324, 328 (1978). Res judicata differes from collateral estoppel in that collateral estoppel applies when specific issues have been litigated in a previous action involving

a different claim in controversy between the same parties or their privies. Only the resolution of those particular issues will be conclusive in a later suit. Tipler v. E. I. Dupont deNemours and Co., 443 F.2d 125, 128 (1971).

Defendants contend that the issue of cattle ownership in this fact situation was adjudicated before the Honorable George Paine at the November equitable subordination hearing in Bankruptcy Court. The plaintiffs' position, however, is that there is no identity of issues between the equitable subordination hearing and this action. Plaintiffs submit that the issue of cattle ownership was not specifically determined, and that the Bankruptcy Court was not called upon to determine the Trustee's liability for conversion. Finally, plaintiffs claim that since this

action was commenced prior to the equitable subordination hearing, this Court is the proper forum for adjudication.

Plaintiffs' contention that this Court is the proper forum for adjudication of this action because the instant proceeding was commenced first is without merit. The Sixth Circuit has stated:

> Where two actions involving the same issue are pending between the same parties, "irrespective of which action or proceeding was first brought, it is the first final judgemnt rendered in one of the courts which becomes conclusive in the other as res judicata." (citations omitted).

Westwood Chemical Co., Inc. v. Kulick, 656 F.2d 1224, 1227 (6th Cir. 1981). The

judgment entered by Judge Paine in the bankruptcy hearing is final. No appeal has been taken. Thus, despite the fact that plaitniffs had initiated this suit prior to the Trustee's commencement of the equitable subordination action, Judge Paine's ruling is entitled to preclusive effect provided res judicata applies.

On aspect of res judicata is issue preclusion. Defendants submit that the central issue involved in this litigation, that is, whether the plaintiffs owned the cattle, was decided in the November equitable subordination hearing. Plaintiffs contend that the Bankruptcy Court was not called upon to determine the factual issue of cattle ownership nor the Trustee's conversion liability. The Court holds that the issue of cattle ownership was in dispute at the bankruptcy proceeding. If the

plaintiffs had proved that they owned the cattle at the November bankruptcy hearing, Judge Paine would not have granted the Trustee's request for equitable subordination.

In order to establish that subordination is appropriate, McLemore had to prove that: (1) the claimant engaged in some type of inequitable conduct; (2) the misconduct resulted in injury to the creditors of the bankrupt or conferred an unfair advantage to the claimant; and (3) the equitable subordination of the claimant was not inconsistent with the provisions of the bankruptcy code. Benjamin v.Diamond (In Re Mobile Steel Co.), 563 F.2d 692, 700 (5th Cir. 1977); see also In re B & L Laboratories, 62 B.R. 494, 510 and n. 36 (M.D. Tenn. 1986). If the plaintiffs had proved that the Trustee was liable for

converting cattle owned free and clear by the Chitwoods, equitable subordination of the plaintiffs claim would be inconsistent with the bankruptcy code. Thus, the question of whether the Chitwoods owned the cattle was clearly an issue in the bankruptcy proceeding. Indeed, Judge Paine determined that at the time defendant Trustee found the cattle on the farm, the cattle had been "indiscriminately branded without any attempt being made to determine the true interest holder."

The doctrine of res judicata also encompasses the concept of claim preclusion. In Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371 (1940), the United States Supreme Court recognized that each party to a bankruptcy proceeding must raise all relevant issues and claims at that time. The

Court stated:

> [T]he remaining question is simply whether respondents having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, were privileged to remain quiet and raise it in a subsequent suit. Such a view is contrary to the well-settled principle that res judicata may be pleaded as a bar, not only as respects matters actually presented to sustain or defeat the right asserted in the earlier proceeding, "but also as respects any other available matter which might have been presented to that end." (citations omitted).

Id. at 378. Clearly, plaintiffs should have raised their conversion claim in the

November hearing. Furthermore, an identity of issues exists when there is an identity of facts giving rise to the cause of action. Westwood Chemical, 656 F.2d at 1227. The plaintiffs' claim of conversion against the Trustee is supported by the same facts giving rise to the Trustee's equitable subordination claim. Plaintiffs are not entitled to pursue the conversion claim because they had an opportunity to litigate the facts in the November bankruptcy hearing. The Court therefore finds that the application of res judicata is appropriate in this case and hereby DENIES plaintiffs' motion to set aside the Order of summary judgment.

SUMMARY

This action arises out of certain cattle lease agreements between plaintiffs and Willard and Ivanelle

Weaver, d/b/a Circle W. Dairy Farms. When the Weavers declared bankruptcy, defendant Trustee managed and liquidated their bankruptcy estate. Plaintiffs allege that because they terminated their lease agreements prior to the Weaver's declaration of bankruptcy, defendant sold cattle owned by the plaintiffs. Defendants allege that plaintiffs had the opportunity to litigate their claims in a bankruptcy hearing held between these parties in November of 1987. The Court finds that plaintiffs are precluded from bringing a conversion claim to trial in this action. The Court therefore DENIES plaintiffs' motion to set aside the Court's previous Order of summary judgment.

An Order will be entered simultaneously with this Memorandum.

This the 19th day of September, 1988.

s/ John T. Nixon
UNITED STATES
DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF TENNESSEE, NASHVILLE DIVISION

RICHARD E. CHITWOOD, ET UX.	)	
VS.	)	DOCKET NO. 1-84-0071
JOHN C. MCLEMORE, TRUSTEE IN BANKRUPTCY FOR CIRCLE W. DAIRY FARMS, ET AL.	)	

ORDER

In accordance with the simultaneously entered Memorandum, the Court hereby DENIES plaintiffs' motion to set aside the Court's Order, entered July 1, 1988, granting the defendants' motion for summary judgment.

Entered this the 19th day of September, 1988.

s/ John T. Nixon
UNITED STATES
DISTRICT JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE

IN RE:	)	
	)	
JOHN C. MCLEMORE, TRUSTEE,	)	
	)	
Respondent,	)	
	)	
WILLARD R. WEAVER and IVANELLE WEAVER, CIRCLE W. DAIRY FARMS,	)	Bk. No. 182-03124
	)	
Debtors,	)	
	)	
v.	)	Adv. Proc. No. 187-0301
	)	
RICHARD E. CHITWOOD,	)	
	)	
Movant.	)	

ORDER

This matter came to be heard on the response of the trustee to the objection of Richard E. Chitwood and Emma A. Chitwood (Chitwoods) to stipulations and an order of disbursement previously entered by the court. The trustee asserted equitable subordination in

defense to the Chitwood's objections. As a precaution the trustee filed a complaint seeking equitable subordination or the claims and/or interests of the Chitwoods.

Testimony was presented by the trustee through H. E. McGaughlin, Jerry Sandlin and John C. McLemore. Pursuant to stipulations of counsel the testimony of Richard E. Chitwood as offered August 3, 4, and 5, 1987 in the trial of Chitwood v. McLemore, #1:81-00071 United States District Court for the Middle District of Tennessee was introduced. From the evidence presented the court makes the following Finding of Facts and Conclusions of Law.

1. The Court finds that the witnesses H. E. McGaughlin and Jerry Sandlin were creditable and believable. This court makes this finding based on

the demeanor and appearances of the witnesses at the hearing of this cause. Previously, in an order entered September 17, 1982, this court determined after extensive examination and cross examination that the witness Sandlin was a creditable and believable witness. The Findings of Fact and Conclusions of Law which accompanied that order were introduced as Exhibit 1 in this proceeding.

2. The court has reviewed the testimony of Mr. Chitwood in the above-referenced District Court trial and finds that at best his testimony was evasive and confusing and at worst untruthful. Mr. Chitwood, although represented by counsel, chose not to attend the hearing on this matter. No reason was offered for his absence and the court finds Mr. Chitwood's failure to appear is unusual. He did appear and testify in the District

Court proceeding which he has initiiated against the Trustee. This court in the above Findings of Fact and Conclusions of Law on September 17, 1982 stated: "(T)he court is of the opinion that Emanuel Renzi, John Sarty and Richard Chitwood may have acted in consort with at least Mr. Weaver in removing assets of the estate to the Hill farm. Because of a possible violation of 18 U.S.C. 152 the Court will refer this matter to the U.S. Attorney's Office for an appropriate investigation. Copies of the Court Order will be mailed to Messrs. Renzi, Sarty and Mr. Chitwood."

3. Based on a review of all the testimony presented to the court the court finds that because of the acts of Mr. Chitwood all claims and/or interests of Chitwood should be subordinated to the claims and interests of other parties in

the case.

4. The unrebutted testimony in this case establishes that Chitwood attempted to coerce other persons who had leased cows to the debtor, Willard Weaver, to invest additional funds in the Weaver operation so that Mr. Weaver could avoid bankruptcy. Proof establishes that Mr. Chitwood suggested that failure to invest additional funds and cooperate with Mr. Weaver could result in uncooperative investors having their cows turn up missing or "banged out" which would result in those parties losing substantially all their investment. The court finds that Chitwood made these threats in an attempt to coerce the other parties to contribute to the hopeless situation existing on the Weaver farm.

5. Mr. Chitwood testified he directed that cows allegedly belonging to

him be removed from the Willard Weaver Farm. This removal was accomplished after the filing of bankruptcy by Weaver and resulted in a financial burden to the estate in determining the location of the cattle and returning those cattle to the farm being operated by the estate. This financial burden is especially egregious in the instant case where the estate has minimal assets.

6. The court finds that the cows on the Weaver Farm were there, as a result of leases with various persons or were owned by Weaver and subject to duly perfected security interests of creditors. Those cattle were indiscriminatorily branded without any attempt being made to determine the true interest holder. The court finds that this indiscriminate branding was either with the approval or acquisitence of Chitwood

or at his direction. This finding is based upon the unrebutted testimony of Mr. McGaughlin regarding threats made as to what could happen to the cattle belonging to persons who did not cooperate with Chitwood or Mr. Weaver. It is supported by Mr. Sandlin who has testified he participated in the branding, worked without ownership records, and followed his directions to brand with the Sardi (BJ), Rezi (ER) or Chitwood (REC) irons without regard for the true ownership of the cattle. In addition Chitwood testified that on September 6, he was able to identify 150 of his cows and that this identification was from his brands on those cows. The clear testimony presented in this court was that most of the branding of cattle occurred after September 7 or shortly before the moving of the cattle to the

Hill Farm in October. When the cattle returned from the Hill Farm 151 cattle were branded with the Chitwood brand, including one which had both the ER and REC brand.

7. Therefore the court finds that Chitwood did not testify truthfully as to the number of cattle carrying his brand on September 6, 1982. Additionally the court finds the untruthfulness of Chitwood's testimony is illustrated by the fact that the information submitted to the trustee by Chitwood and his counsel seeking to claim cows including cows which did not carry Chitwood's REC brand, but were marked with the BJ or ER brand. This court in previous Findings of Fact and Conclusions of Law referenced herein has made lengthy findings regarding the untruthfulness of the debtor. The court finds that Chitwood

was acting in concert with the debtor, Willard Weaver.

8. Chitwood is guilty of misconduct.

9. The misconduct resulted in injury to the creditors of the estate both in actual expenses incurred by the estate and loss to other claimants and interest holders whose cattle cannot be accurately identified.

10. The court finds that all claims and interests of Chitwood should be subordinated to claims and interests of other persons ascertaining such claims and interests in this estate and that such subordination should include any monies previously paid to Chitwood from the estate for any previously allowed administrative claim. Any money so paid by the estate to Chitwood should be returned to the estate. The trustee is

directed to take the appropriate action to recover such money in the event a payment has been made.

IT IS SO ORDERED.

/s/ George C. Paine, II
United States
Bankruptcy Judge

Prepared for Entry:

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/s/ Paul E. Jennings
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Nashville, TN 37201
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Supreme Court, U.S.
FILED
OCT 1
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 90-428

In The

Supreme Court of the United States

October Term, 1990

RICHARD E. CHITWOOD and
EMMA A. CHITWOOD,

Petitioners,

v.

JOHN C. McLEMORE, TRUSTEE IN BANKRUPTCY
FOR CIRCLE W. DAIRY FARMS, et al.,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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PARTIES TO THE PROCEEDING BELOW

The petitioners in this action are Richard E. Chitwood and Emma A. Chitwood. The respondent in this action is John C. McLemore, Trustee in Bankruptcy for Circle W. Farms, Inc., Willard R. Weaver and Ivanell Weaver.

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STATEMENT OF THE CASE

On September 26, 1982, the debtors Willard R. Weaver, Ivanell Weaver, and Circle W. Dairy Farms filed for bankruptcy in the United States Bankruptcy Court for the Middle District of Tennessee. On October 21, 1982, John C. McLemore was appointed as bankruptcy trustee.

Prior to September, 1982, Richard E. Chitwood and Emma A. Chitwood leased dairy cows to the Weavers. After the Weavers filed for bankruptcy, the Chitwoods directed that any cattle which they might own should be removed from the bankrupt's estate. When McLemore was appointed trustee, he went to the Weaver farm expecting to find over 1,000 head of cattle. Instead, he found approximately 40 head of cattle. McLemore began a search for the missing cattle, eventually locating 400 of them, and returned the cattle to the Weaver farm.

McLemore attempted to run the farm, but it soon became necessary to liquidate all the assets. On February 4, 1983, McLemore duly notified creditors, including the Chitwoods, that he would sell all cattle located on the debtor's farm, free and clear of all rights and claims by lien, ownership, or otherwise, and apply to the reorganization court for an order authorizing the sale. The Chitwoods, through counsel, filed and served written objections to the sale, but the objections were thereafter withdrawn.

On February 15, 1983, a hearing was held before the Honorable George C. Payne, II, who approved the trustee's application and sale. The sale was later confirmed by an order signed by the Honorable Thomas A. Wiseman, Jr., which provided, in pertinent part, that:

(1) the sale price obtained by the trustee was reasonable;

(2) all objections to the sale, with one exception not material to the issues presently before this Court had been withdrawn;

(3) the rights of all parties concerning any interest in the cattle attached to the proceeds, any claimants to promptly file pleadings to adjudicate the same; and

(4) the trustee could use the proceeds to satisfy prior borrowings from the Third National Bank.

The Chitwoods then commenced an independent diversity action against the trustee, alleging that the trustee's sale constituted a conversion of the cattle (original Count I), that the trustee had negligently cared for the cattle prior to sale (original Count II), that the cattle sold by the trustee were subject to Plaintiffs' interests as lessors (original Count III), and that a constructive trust for their benefit was imposed upon the proceeds of sale (original Count IV). The Chitwoods later amended their complaint to assert claims for money had and received in the court-approved sale (substituted Count I), unjust enrichment of the trustee's pre-sale possession of the subject cattle (substituted Count III), trespass from the trustee's action in obtaining possession of the cattle (substituted Count IV), and conversion arising out of the trustee's possession, pledge and disposition of the subject cattle (new Count V). The underlying issue on all counts of the Complaint was the ownership of cattle found on the Weaver farm. Before any recovery could be allowed in the diversity action, the Plaintiffs necessarily had to prove that they owned the cattle. If the Plaintiffs were not

owners of the cattle, then no recovery could be had. The trial began on the district court action before the District Judge Thomas A. Wiseman, Jr. on August 3, 1987. On the third day of trial, Judge Wiseman declared a mistrial and recused himself when it was discovered that he, himself, had signed the order approving the sale of the cattle in May of 1983. The case was placed upon the docket of District Judge John T. Nixon for retrial.

In the related bankruptcy proceeding, in response to the Chitwoods' objections to stipulations and an order of disbursement previously entered by the Court, the trustee asserted an equitable subordination defense to the Chitwoods' objections and also filed an independent complaint seeking equitable subordination of all claims and interests of the Chitwoods. The bankruptcy court heard evidence in this equitable subordination proceeding, and on November 25, 1987, the court entered an order which specifically found that "the cows on the Weaver farm were there, as a result of leases with various persons or were owned by Weaver and subject to duly perfected security interests of creditors. Those cattle were indiscriminately branded without any attempt being made to determine the true interest holder." The court further found that Richard Chitwood was guilty of misconduct which resulted in injury to the creditors "of the estate, both in actual expenses incurred by the estate and loss to other claimants and interest-holders whose cattle cannot be accurately identified." In reaching factual findings that the cattle on the Weaver farm, which were the subject of the sale, were owned by "various persons or by Weaver" and could not be accurately identified, the court

obviously determined the issue of ownership and adjudicated the rights of the creditors, including the Chitwoods. The United States Bankruptcy Court, therefore, reached specific findings that the ownership of the cattle could not be determined.

In April 1988, McLemore moved for summary judgment in the district court case on the grounds that the judgment and findings of the bankruptcy court in the equitable subordination adversary proceeding barred litigation of the Chitwoods' complaint under the doctrine of *res judicata*. The district court granted summary judgment and the Sixth Circuit Court of Appeals affirmed the summary judgment in a *per curiam* opinion.

SUMMARY OF ARGUMENT

Issue preclusion (collateral estoppel) bars the Chitwoods from asserting the claims made the basis of the district court action because the bankruptcy court specifically found that ownership of the cattle could not be determined. Claim preclusion bars the Chitwoods' claims because permitting the district court lawsuit to proceed would undermine the bankruptcy court's judgment and nullify or impair settled rights. Fed.R.Civ.P. 13(a)(1) does not apply to the failure to assert defenses and does not insulate a party who fails to assert a defense or counterclaim in a subsequent proceeding from the application of *res judicata* even though Rule 13(a)(1) may not require the assertion of a counterclaim where litigation of the pending claims would impair the judgment in the subsequent action or nullify settled rights.

REASONS FOR DENYING THE PETITION FOR WRIT OF CERTIORARI

I. The Trial Court Properly Granted Summary Judgment Because The Chitwoods' Claims Are Precluded By The Doctrine Of *Res Judicata*.

The Chitwoods' claims against McLemore are completely premised upon the supposed fact that McLemore sold cattle that belonged to the Chitwoods.[1] The achilles heel of petitioners' argument, however, is that the United States Bankruptcy Judge's order following the equitable subordination adversary proceeding specifically found that the cattle in question were owned by "various persons or were owned by Weaver [the debtor]" (Order at page 3) and that "Those cattle were indiscriminately branded without any attempt being made to determine the true interest holder" such that the identity of the cattle "cannot be accurately identified." (Order at page 4). Simply put, the bankruptcy court's equitable subordination order and findings preclude the Chitwoods from raising a claim in district court because allowing such a subsequent action would plainly operate to undermine the initial judgment and impair or nullify rights that were established in the equitable subordination action.

---

[1] Petitioners' Brief repeatedly makes this assertion: "As amended the complaint stated five grounds for relief arising from respondent's taking of petitioners' cattle . . . " (Petitioners' Brief, page 6); " . . . the bankrupt estate had no right to petitioner's [sic] cattle" (Petitioners' Brief, page 12); "How many cattle did petitioners own?" (Petitioners' brief, pages 14-15).

The equitable subordination proceeding was an important and formal adversary proceeding under Bankruptcy Rule 7001 and 11 U.S.C. § 510(c). The whole purpose of the equitable subordination proceeding is to determine whether a creditor has engaged in misconduct which has resulted in injury to other creditors or has conferred an unfair advantage on the creditor such that subordination of the claim would not be inconsistent with the bankruptcy act. 3 *Collier on Bankruptcy* § 510.05 (1989). As Judge Payne's Bankruptcy order of November 25, 1987 clearly indicates, Richard Chitwood was an active participant in a scheme to coerce investors to invest additional funds in the Weaver operation, and to indiscriminately brand cows such that they were incapable of being identified. The court specifically found that the indiscriminate branding was done either with the approval or acquiescence of Chitwood, or at his direction. (¶ 6 Bankruptcy Judge's Order.) Under the circumstances, in order to adjudicate the rights of the creditors, equitable subordination of the Chitwood claims was deemed appropriate. To permit the Chitwoods to now obtain funds through a suit premised on ownership rights found not to exist would clearly undermine the bankruptcy court's judgment and impair the rights which were established in the equitable subordination proceeding.

The seminal decision establishing claim preclusion against a defendant where a subsequent action would undermine the force of a prior judgment or impair settled rights is *Chicot County Drainage District v. Baxter State Bank*, 308 U.S. 371, 60 S. Ct. 317, 84 L.Ed. 329 (1940). In

Chicot, a drainage district instituted a proceeding to reorganize debt pursuant to a federal law allowing municipal debt adjustment. This lawsuit resulted in a plan of readjustment and a formal decree. Later, a bank whose debt had been "readjusted" filed a separate action to recover bonds held by the drainage district. The essence of the bank's claim was that the federal law allowing the municipal debt adjustment was unconstitutional. The drainage district pleaded *res judicata* and pointed to the prior decree as a bar to the bank's claim. This Court held that *res judicata* precluded the bank's claim because the bank had notice of the proceeding of debt readjustment, had an opportunity to present objections, and yet had raised no questions concerning the validity of the act at the debt readjustment proceeding.

The legal test for determining claim preclusion is not whether the five counts of the Chitwoods' complaint are compulsory counterclaims under Fed.R.Civ.P. 13(a). Petitioners' brief fundamentally misconstrues the relationship between the compulsory counterclaim rule, F.R.Civ.P. 13(a), and *res judicata* as applied to a party in a second action who failed to interpose a claim or defense in the initial action where that party was a defendant. Rule 13(a) speaks of the necessity or compulsion of advancing claims for relief as counterclaims. The justification for compulsion is premised both upon principles of waiver and estoppel. 3 *Moore's Fed. Prac.* § 13.12 [1] at 13-52 – 55 (2d ed. 1989). If the *claim* is already the subject of another pending action, the "compulsion rule" set forth in Rule 13(a) does not apply by virtue of the express exception to the compulsory counterclaim rule set forth

in Rule 13(a)(1). The language of the Rule 13(a)(1), however, which provides that "the pleader need not state the claim if at the time the action was commenced the claim was the subject of another pending action," simply does not address whether: (1) *defenses* should or must be averred, even if the defenses are the subject of a claim in another pending action; and (2) whether pleading a counterclaim may be required by some command of law *other than* the compulsion principle set forth in Rule 13(a). Respondent submits that *res judicata* (including claim and issue preclusion) may well call for precluding the subsequent litigation of claims after a court judgment in the "second" action even though Rule 13(a) did not require the assertion of a counterclaim. The "need not" provision of Rule 13(a)(1) cannot be construed to prevent preclusion in all circumstances. As a leading treatise notes:

> "Rule 13(a), for example, does not require assertion of counterclaims that are already subjects of a pending action, yet circumstances may arise in which pursuit of the pending action should be precluded after judgment in the later-instituted action." Wright, Miller & Cooper, 18 *Fed. Prac. & Proced.* § 4414 at 110 (1981).

Numerous cases have applied issue and claim preclusion to bar claims which were not compulsory counterclaims under Fed.R.Civ.P. 13(a). In *Circle v. Jim Walter Homes, Inc.*, 654 F.2d 688 (10th Cir. 1981), home buyers brought a suit for alleged violations of the Uniform Commercial Credit Code. The court held that the suit was barred by a prior foreclosure suit and observed: "The same basic set of facts, of course, may constitute both a defense to a claim by an opposing party and the basis of a lawsuit against the party." 654 F.2d at 690. The court

ruled that principles of *res judicata*, specifically the common-law compulsory counter claim rule, precluded the subsequent suit, even though the claims for Uniform Commercial Credit Code violations in the second action were not compulsory counterclaims in connection with the prior foreclosure suit. The court determined that allowing the subsequent action to proceed would operate to undermine the initial judgment and nullify established rights. *Id.*

Other courts have reached the same result (preclusion) by applying *res judicata*, even though the formal requirements of a compulsory counterclaim were absent. *See County Fuel Co., Inc. v. Equitable Bank Corp.*, 832 F.2d 290 (4th Cir. 1987) (debtor's failure to assert a breach of contract claim to a proof of claim filed by a creditor in bankruptcy court barred a subsequent suit for breach of contract against the debtor on principles of waiver even though the breach of contract claim was not a compulsory counterclaim in the bankruptcy action); *Martino v. McDonald's System, Inc.*, 598 F.2d 1079 (10th Cir. 1979), *cert. denied*, 444 U.S. 966 (1979) (held that even though Rule 13(a) did not apply since the first action was settled prior to pleading, a franchisee was barred by failure to assert an antitrust defense in the initial suit because "successful prosecution would nullify rights established by a consent judgment in the earlier action." 598 F.2d at 1085); *Rudell v. Comprehensive Accounting Corp.*, 802 F.2d 926 (7th Cir. 1986) (held that the failure to assert a defense in a previous arbitration proceeding precluded franchisees from bringing action alleging agreement was procured by fraud. Once again, the formal requirements of Rule 13(a) did not require pleading defenses in the

initial action); *Henry v. Farmer City State Bank*, 808 F.2d 1228 (7th Cir. 1986) (failure to assert a defense barred a subsequent action. The court noted in a footnote (footnote 7) that defenses are different from a counterclaim and may be asserted even without bringing a counterclaim for affirmative relief); *Yentile v. Howland*, 26 Mass. App. Ct. 214, 525 N.E.2d 689 (Mass. App. Ct. 1988) ("The 'salutary' and well-established rules against claim-splitting . . . preclude the Yentiles from attempting in a pending or subsequent action to undermine the Land Court judgment establishing the validity of the option. They may not raise a claim in the Superior Court which was available as a defense in the Land Court action. [citing numerous authorities.]" 525 N.E.2d at 690).

Petitioners seek to apply the language in Federal Rule of Civil Procedure 13(a)(1) that compulsory counterclaims "need not" be asserted if such claims are the subject of a pending action as a blanket protection or insurance against any adverse affect which may arise from failing to interpose a claim or a defense in the second action. The rule, however, provides no such safe harbor. No statute or rule can speak or apply to every situation which conceivably may arise. Although Rule 13(a)(1) does not require setting forth an affirmative claim for relief as a compulsory counterclaim, the compulsion and waiver principles set forth in Rule 13(a) are not the limits of the *res judicata* universe and cannot be said to control how a court, such as the district court in this case, should handle a clear conflict between the judgment and findings entered by the bankruptcy court and the affirmative claims for relief brought by the Chitwoods in their district court action. To protect the

decision of the bankruptcy court and the rights established by the bankruptcy court's judgment, it was well within the equitable power of the district court to preclude the Chitwoods from bringing their claims, even though the district court lawsuit had been filed prior to the equitable subordination bankruptcy proceeding. A defendant may be precluded from bringing a claim where successful presentation of the action would nullify a judgment or would impair rights established in the initial judgment. RESTATEMENT (SECOND) JUDGMENTS § 22(2)(b) (1982), Comment (f), ("Special circumstances under which failure to interpose a counterclaim will operate as a bar.") As the RESTATEMENT (SECOND) JUDGMENTS point out in Illustration 10 to § 22:

> "A brings an action against B to acquire title to certain real estate and obtains judgment by default. B then brings an action against A to acquire title to the same property, alleging that, at the time of the first action, B had acquired title to the property by adverse possession. The action is precluded." RESTATEMENT (SECOND) JUDGMENTS § 22, Illustration 10 at page 190 (1982).

In short, *res judicata* fully applies in this case because the Chitwoods were a party to a formal adversary proceeding – the equitable subordination claim – pursuant to Bankruptcy Rule 7001 and 11 U.S.C. § 510(c). The entire purpose of the equitable subordination proceeding was to adjudicate the rights of creditors, including the Chitwoods. The issue of cattle ownership was directly addressed by the bankruptcy court's findings that, because of Chitwood's misconduct and the circumstances at the Weaver farm, the ownership of the cattle could not

be determined. In ruling in favor of the trustee at the equitable subordination proceeding, the court specifically found the necessary elements for equitable subordination:

> (1) the Claimant engaged in some type of inequitable conduct;
>
> (2) the misconduct resulted in injury to the creditors of the bankrupt or conferred an unfair advantage to the Claimant; and
>
> (3) the equitable subordination of the Claimant was not inconsistent with the provisions of the bankruptcy code." Bankruptcy Order at p. 4. *See Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977).

Bankruptcy Courts are empowered to subordinate claims of creditors where subordination will support a joint and equitable distribution of the bankrupt estate. *Pepper v. Litton*, 308 U.S. 275, 60 S.Ct. 238, 84 L.Ed. 281 (1939). The fundamental aim of equitable subordination is "to undo or offset any inequality in the claim position of a creditor that will produce injustice or unfairness to other creditors in terms of the bankruptcy results." *Trone v. Smith (In re Westgate-California Corp.)*, 642 F.2d 1174, 1177 (9th Cir. 1981). It is clear by the bankruptcy judge's findings of fact and conclusions of law that a good part of the inequitable conduct exhibited by the Chitwoods was the role Mr. Chitwood played in the indiscriminate branding of the cattle. The indiscriminate branding was done without a determination of the true interest holder, thus making it impossible to determine the owner(s) of the cattle. The cattle were branded with the Chitwood

brand (REC) without regard to whether the cattle truly belonged to Chitwood. (¶ 6 Bankruptcy Judge's Order).

The proper time to determine the ownership of the cattle was during the adversarial proceeding regarding the trustee's equitable subordination claim against the Chitwoods. Mr. Chitwood, however, although represented by counsel, chose not to appear. Also, no appeal was taken from the judge's order. The reorganization court's order thus bars the Chitwoods from any remedy based upon ownership of the cattle. *Southmark Properties v. Charles House Corp.*, 742 F.2d 862, 871 (5th Cir. 1984) (prior judgment concludes all claims arising out of "common nucleus of operative facts"); *Robinson v. First National City Bank*, 482 F.Supp 92 (S.D.N.Y. 1979), (court held that since neither of the parties appealed the reorganization court's approval of compromise and settlement of securities law and fraud claims, the bankruptcy adjudication was considered the final judgment of the merits of those claims, and thus, plaintiff's settlement in the reorganization proceedings barred relitigation of those claims before the district court).

Issue preclusion, or the principle of collateral estoppel, clearly bars the Chitwoods from asserting the claims made the basis of the district court action. As Judge Nixon's summary judgment memorandum makes clear, the issue of cattle ownership was in dispute at the bankruptcy proceeding and Judge Payne specifically found that the cattle on the farm had been indiscriminately branded without any attempt being made to determine the true interest owner. The court further found that the

cattle on the Weaver farm were owned by various persons, including the Weavers, and that specific ownership simply could not be determined.

The Chitwoods' claims are predicated upon the same facts which gave rise to the trustee's equitable subordination claim. The central issue in both cases was ownership and rights to particular cattle. That issue was decided by the bankruptcy court adversely to the Chitwoods. Relitigation would only undermine the bankruptcy court judgment and disturb settled rights in contravention of the law of collateral estoppel.

CONCLUSION

The Chitwoods were unsuccessful in obtaining money from the bankruptcy estate through the bankruptcy court. In part, this was because of their own misconduct in indiscriminate branding of cattle which precluded proper identification of ownership interests. The Chitwoods must not now be allowed to assert claims predicated upon grounds which they have, or could have, interposed in response to the complaint filed regarding the subordination of their interest in the Weaver estate. To do so would violate the doctrine of *res judicata*. Although Fed.R.Civ.P. 13(a)(1) did not mandate that the Chitwoods file counterclaims in the equitable subordination action, the bankruptcy court's findings and judgment now bar the Chitwoods' claims.

Respondent respectfully requests that this Court deny the petition for certiorari.

Respectfully submitted,

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